Q410 Earnings Call Prepared Remarks
February 3, 2011

John

Thank you for joining us. Craig Donohue, our CEO, and Jamie Parisi, our CFO, will spend a few minutes outlining the highlights of the fourth quarter and then we will open up the call for your questions.

Before they begin, I'll read the safe harbor language. Statements made on this call, and in the accompanying slides on our Web site, that are not historical facts are forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or implied in any forward-looking statements. More detailed information about factors that may affect our performance may be found in our filings with the SEC, including our most recent Forms 10-K and 10-Q, which are available in the Investor Relations section of the CME Group Web site.

During this call, we will refer to GAAP and non-GAAP results. A reconciliation is available in our press release, as well as within an income statement trend file on the investor relations portion of our Web site, which contains historical quarterly results on a GAAP basis.

Now, I would like to turn the call over to Craig.

Craig

- Thank you for joining us today on the CME Group fourth quarter earnings call.

- For the quarter, CME Group posted solid results of $763 million of revenue, $458 million of operating income, and an operating margin of 60 percent.

- I'll let Jamie get into the details on the financial results, while I'd like to take the opportunity to talk about the big picture environment for CME Group and our customers.

- For the entire financial services industry, the past two years have been filled with challenges and uncertainty on many fronts. I think we can all agree that there is still a fair amount ahead, but as I look back on CME Group's response to this environment, I can see remarkable progress.

- We've consistently worked to support the users of our core products, provide fact-based analysis and insight on prevailing market conditions, and look for opportunities to develop new products. This work has enabled us to launch exciting new products such as the Ultra Bond Treasury Futures, which traded 34,000 contracts per day in January, and provide a variety of new and useful analytical tools to our customers. In turn, these allow us to have more meaningful conversations with market participants about their trading needs and continue to evolve new offerings for customers.

- We've worked with regulators, customers, and service providers to develop and launch a cleared over-the-counter interest rate swaps offering, which has cleared over $980 million since launch. We are in what we consider very early stages with this offering, but we are pleased to note that the necessary operational and risk management frameworks are robustly functioning, as evidenced by the cleared activity to date, and early participation has come from a diverse group of firms. Since our initial launch, we've added two clearing members, RBS and Wells Fargo, highlighting the positive reception the offering is getting from market participants.

- We received all necessary approvals for the launch of CME Clearing Europe, an offering which provides us with long-term strategic flexibility in our efforts to meet global customers' needs. We are on track to begin clearing nearly 100 over-the-counter energy products later this year, and from there, we will expand to other over-the-counter and listed products. Approximately 20 firms are currently in talks to participate in the offering, including potential clearing members and customers.

- We built upon years of education in Washington to call for a measured response to financial regulation, one that doesn't create unintended consequences and doesn't put US markets at a disadvantage. We recognize that while the exchange-traded markets largely will see fairly minimal impacts from Dodd-Frank, regulations for the over-the-counter markets are ongoing. We continue to advocate not just for our benefit, but for sound, economically rational regulation. 2011 will be a determinative year in this process and we are committed to the high level of engagement we've shown so far.

- We bolstered our products and services capabilities and our global reach via multiple strategic initiatives. We added Dow Jones Indexes to our product family and Elysian Services to our technology suite.

- On the global front, we deepened our BM&FBOVESPA relationship by initiating a joint, multi-asset class platform development effort. Beyond BM&F, we launched or expanded relationships with multiple global partners including Bursa Malaysia, Nikkei Inc, the National Stock Exchange of India and Bolsa Mexicana. Combined, these efforts help to expand our global membership and clearing member base and generate opportunities in markets outside the US, where we believe customer acquisition initiatives can generate significant long-term growth for us.

- Throughout all of these strategic efforts, we further strengthened CME Group's strong financial position by paying down debt, and we laid the groundwork for the ongoing return of capital to our shareholders, which Jamie will discuss in more detail.

- I'll now provide a few key product highlights for the year.

- The interest rate complex ended the year up 28 percent. While this impressive growth was obviously off a down year, we feel that many of the trends in 2010 signal that macroeconomic conditions are continuing to support a more active interest rate environment. We've talked before about how Treasuries have seen higher rates of growth than Eurodollars as volatility has come back into the long end of the curve. This is consistent with activity we saw during a prior extended period of Fed inactivity from June 2003 to May 2004. Treasuries in 2009 were 43 percent of total interest rate volume and in 2010 were 48 percent.

- FX had a breakout year with 47 percent growth, continuing a trend of being one of the fastest growing segments of the global FX market.

- Ongoing price volatility for physical commodities has created a strong volume environment in agricultural commodities, energy and metals, as expectations for increasing global demand continue to grow. Average daily volume for metals was up 40 percent for the year, and for agricultural commodities, 23 percent.

- Energy average daily volume was up 11 percent for the year, with crude and refined products up 21 percent. Natural gas markets have experienced very low volatility given the increased Northeast shale production and average daily volume in these products was up 2 percent. The energy complex posted strong growth of 22 percent for January as well, with 47 percent volume growth in our WTI products. This strong volume reflects the world energy market's reliance on WTI as an indicator of global macroeconomic fundamentals. We were particularly pleased to announce new daily volume records in our benchmark WTI futures and options, which traded a combined 1.7 million contracts on January 28th, with WTI options posting a second consecutive record on the following trading day as well.

- In the fourth quarter, volume during non-US hours represented 16 percent of our Globex volume, the highest quarterly percentage we've seen, as it grew 33 percent compared to Q4 of 2009. We saw considerable strength in interest rates and agricultural products during the overnight period, up 38 percent and 107 percent respectively. It's exciting to see the liquidity deepen throughout the entire day, and we are poised to build on that liquidity by introducing our globally relevant products to new customers.

- I'll close my comments today with a brief update on regulation and the implementation of the Dodd-Frank Act. As you know, the CFTC is working towards its July deadline for enacting rules in support of Dodd-Frank. As things now stand, there are numerous open issues, many of which are to a large degree intertwined. However, as I mentioned earlier, it is important to note that most of these issues are specific to the over-the-counter markets, with very minimal impacts expected for the exchange-traded markets. We are supportive of measures that will reduce systemic risk while preserving the flexibility and customization of over-the-counter markets that allows them to serve customers and provide innovation.

- We anticipate that given the July deadline, we'll have much more clarity on key issues at that time. In general, a significant focus of our work in Washington is to ensure that proposals currently advanced do not impose excessive compliance costs and other burdens on market participants. It is critical to the health and competitiveness of the US markets that we avoid unnecessary and overly prescriptive regulation. We will continue to actively work with regulators and market participants towards these ends.

- To summarize, in this era of significant change for financial services, CME Group has been successful at not only building our own business for the future, but also with contributing to the regulatory process and laying the groundwork for our customers to move their own businesses forward under evolving market frameworks. We see good indications that the fundamental drivers of the core business will help us sustain growth, and we are optimistic about the long-term prospects for our developing over-the-counter and global initiatives.

- Now, I will turn the call over to Jamie to discuss the financials.

Jamie

- Thank you Craig.

- CME Group posted solid fourth quarter financial results, with average daily volume of 12 million contracts per day, up 17 percent versus Q4 of last year, driving a 14 percent increase in revenue to $763 million. There are a couple items included in our GAAP results that I'd like to walk through.

- First, our GAAP tax expense included a $51.3 million non-cash charge to record a deferred tax liability revaluation due to revised state tax apportionment estimates. These changes in apportionment estimates are normal course and occur each year once we have completed and analyzed our annual tax returns in various jurisdictions. On a related note, in the first quarter of this year, preliminary estimates indicate that the impact of the recently passed Illinois income tax increase will result in a non-recurring revaluation of our deferred tax liabilities of roughly $5 million.

- Second, our GAAP non-operating expense for Q4 included $8.6 million resulting from the acceleration of hedge expenses from 2011 associated with the early payoff of our term loan, which we mentioned in a press release earlier this month. As a result, we will see a decrease in our interest expense, which I'll touch on later.

- Excluding these two items, Q4 net income would have been $253 million, and diluted EPS would have been $3.77.

- The overall rate per contract for the fourth quarter was 81.3 cents, up slightly from the third quarter, driven by offsetting mix factors. On a full year basis, average daily volume was up 19 percent, while the average rate was down 3 percent.

- Market data revenue of $104 million for the quarter was up from the third quarter, due in part to a favorable audit assessment. Subscribers to CME, CBOT and NYMEX data decreased somewhat in Q4, with the total terminal count decreasing to 379,000. Overall for the year, we saw increased revenue as the price increase instituted at the beginning of 2010 had a greater impact than the decrease in reported terminals.

- I'll now take a few minutes to review expenses.

- Drilling into Q4 expenses, compensation and benefits was $120 million. Within compensation, we booked $3.7 million of non recurring expense related to a voluntary self-audit of our employee classification levels. The fourth quarter bonus accrual totaled $22.2 million, higher than we expected at the beginning of the quarter, due to stronger than anticipated Q4 volumes and operating income. Stock based compensation increased sequentially due to our annual grant which occurs in mid-September. At the end of the year, our overall headcount stood at 2,570, an increase of 50 people during the fourth quarter, reflecting our continued investment in growth opportunities.

- Excluding subsidiary employees, our total 2010 employee bonus was $67 million, which came in at the mid-point of our 2010 bonus guidance of $54 million at target and $82 million at maximum. Turning to 2011, our target bonus is $67 million, including subsidiaries.

- During the fourth quarter, we saw a $9 million sequential increase in professional fees due to higher OTC and European clearing expenses, increased regulatory costs related to Dodd Frank, as well as expenses related to the acquisition of Elysian.

- In terms of 2011, we expect total expenses to increase to approximately $1.26 billion, assuming our target bonus payout, up from the $1.17 billion last year, which includes the $20.5 million impairment we booked in Q2 2010. Of the $110 million annual expense increase – about half is tied to our existing core business, which has annual expense growth of roughly 5 percent. This is down from core expense growth in 2010 of approximately 8 percent. The other half of the annual increase is related to higher spending on growth initiatives. These include colocation, higher OTC cost due primarily to operationalizing our offerings, the development of our multi asset class trading platform with BM&FBOVESPA, the building of our European clearing house and costs to create an enhanced front end for energy trading with our acquisition of Elysian in December.

- In the Non-Operating Income and Expense category – the interest rate hedge acceleration drove increased expense as previously mentioned. In terms of 2011 guidance, we expect interest expense to drop to approximately $31 million in the first quarter and then approximately $30 million each quarter thereafter.

- Our effective tax rate in Q4 was 42.0 percent, excluding the tax related charge I mentioned earlier. Looking ahead, due to the announced increase in the Illinois corporate income tax, which is retroactive to the beginning of the year, we expect our effective tax rate in 2011 to increase slightly to approximately 43 percent, excluding any deferred tax liability revaluations.

- Capital expenditures, net of leasehold improvement allowances, totaled $77 million in the fourth quarter, driven primarily by work on our colocation and data center facilities. CAPEX for the year totaled $176 million. In 2011, we expect to spend approximately $180 million on capital.

- 2010 was a record cash earnings year, with CME Group generating $1.1 billion. During the year we paid down debt of $300 million, paid dividends of $305 million, and added to our cash balances to accommodate our various OTC and international clearing efforts. At the end of the fourth quarter, we had approximately $900 million of cash and marketable securities on our balance sheet.

- As many of you are aware, our dividend policy is tied to the prior year's cash earnings total. The CME Group Board of Directors recently approved amending our existing dividend policy to increase our dividend payout from approximately 30 percent of prior year's cash earnings to approximately 35 percent, subject as always to the board's approval and declaration.

- This is an initial step in the capital structure plan we highlighted during our second quarter earnings call. Based on our 2010 results, this change is expected to increase our regular dividend by more than 20 percent. We intend to announce the next quarterly dividend later this month following our February Board meeting. The early pay down of our $420 million term loan, originally due in August 2011, will position us to reach our targeted level of 1 times debt to EBITDA sooner, as we pay down outstanding commercial paper. In addition to the regular dividend increase, we will consider other forms of capital return, likely in the second half of the year, which will potentially include some combination of opportunistic share buybacks and special dividends. One last point, we have adjusted our planned minimum cash levels to $700 million from $500 million, based on fine tuning our estimates of expected guarantee fund commitment for the OTC initiatives we are involved in, and our initial commitment to CME Clearing Europe based on its recent approval by the FSA.

- Turning to recent volumes, our ADV was 12.3 million in January, up 10 percent compared to the prior year, with our commodity related products - agricultural, energy and metals - driving most of the growth.

- We will now open up the call for your questions. In order to get to everyone, we are limiting all of you to one question and one follow up, and then please feel free to get back in the queue if time permits.

Statements in these prepared remarks that are not historical facts are forward-looking statements. These statements are not guarantees of future performance and involve risks, uncertainties and assumptions that are difficult to predict. Therefore, actual outcomes and results may differ materially from what is expressed or implied in any forward-looking statements. Among the factors that might affect our performance are: increasing competition by foreign and domestic entities, including increased competition from new entrants into our markets and consolidation of existing entities; our ability to keep pace with rapid technological developments, including our ability to complete the development, implementation and maintenance of the enhanced functionality required by our customers; our ability to continue introducing competitive new products and services on a timely, cost-effective basis, including through our electronic trading capabilities, and our ability to maintain the competitiveness of our existing products and services, including our ability to provide effective services to the over-the-counter market; our ability to adjust our fixed costs and expenses if our revenues decline; our ability to generate revenues from our processing services; our ability to maintain existing customers, develop strategic relationships and attract new customers; our ability to expand and offer our products outside the United States; changes in government policy, including policies relating to common or directed clearing and changes resulting from the adoption and implementation of the Dodd-Frank Act and any changes in the regulation of our industry with respect to speculative trading in commodity interests and derivative contracts; the costs associated with protecting our intellectual property rights and our ability to operate our business without violating the intellectual property rights of others; our ability to generate revenue from our market data that may be reduced or eliminated by the growth of electronic trading, the state of the overall economy or declines in subscriptions; changes in our rate per contract due to shifts in the mix of the products traded, the trading venue and the mix of customers (whether the customer receives member or non-member fees or participates in one of our various incentive programs) and the impact of our tiered pricing structure; the ability of our financial safeguards package to adequately protect us from the credit risks of clearing members; the ability of our compliance and risk management methods to effectively monitor and manage our risks, including our ability to prevent errors and misconduct; changes in price levels and volatility in the derivatives markets and in underlying fixed income, equity, foreign exchange, interest rate and commodities markets; economic, political and market conditions, including the volatility of the capital and credit markets and the impact of current economic conditions on the trading activity of our current and potential customers stemming from the financial crisis that began in 2008; our ability to accommodate increases in trading volume and order transaction traffic without failure or degradation of performance of our trading and clearing systems; our ability to execute our growth strategy and maintain our growth effectively; our ability to manage the risks and control the costs associated with our acquisition, investment and alliance strategy; our ability to continue to generate funds and/or manage our indebtedness to allow us to continue to invest in our business; industry and customer consolidation; decreases in trading and clearing activity; the imposition of a transaction tax on futures and options on futures transactions and/or the repeal of the 60/40 tax treatment of such transactions; the unfavorable resolution of material legal proceedings and the seasonality of the futures business. More detailed information about factors that may affect our performance may be found in our filings with the Securities and Exchange Commission, including our most recent periodic reports filed on Form 10-K and Form 10-Q, which are available in the Investor Relations section of the CME Group Web site. We undertake no obligation to publicly update any forward-looking statements, whether as a result of new information, future events or otherwise.